



## STATE OF CALIFORNIA

BUSINESS, TRANSPORTATION AND HOUSING AGENCY  
**DEPARTMENT OF CORPORATIONS**  
California's Investment and Financing Authority

### NEWS RELEASE

**04-49**

**Arnold Schwarzenegger, Governor**

**William P. Wood, Commissioner**

FOR IMMEDIATE RELEASE  
Wednesday, December 1, 2004

Contact: Debbie O'Donoghue  
(916) 324-9011

### **California Department of Corporations Announces Study on Effectiveness of California Corporate Disclosure Act, Requests Public Comment**

SACRAMENTO --- The Department of Corporations announced today that it is requesting public comment for a study on the effectiveness of the California Corporate Disclosure Act aimed at providing investor protection. The Act, which was enacted in late 2002, requires that publicly traded companies annually disclose detailed information to the Secretary of State, although most of that information is currently available through the Securities and Exchange Commission's website.

In September 2004, Governor Arnold Schwarzenegger directed that the Department of Corporations, California's securities regulator, review the efficacy of the Act and make recommendations to eliminate duplicative reporting requirements and further align its provisions with federal reporting requirements.

The California Department of Corporations study seeks to review:

- The effectiveness of the Act in protecting California investors against securities and investment fraud and provide enhanced transparency in the financial marketplace;
- The costs and other burdens imposed on publicly traded corporations by the Act; and
- The cost-effectiveness of alternative methods of disclosing the information required by the Act, including through filings required and disseminated by federal regulators.

The Department's request for information can be found on its website at [www.corp.ca.gov](http://www.corp.ca.gov). Interested parties may submit written comments no later than January 14, 2005 by any of the following methods:

Write: California Department of Corporations  
Attn: Kathy Womak, Office of Law and Legislation  
1515 – K Street, Suite 200  
Sacramento, CA 95814  
Fax: (916) 322-3205  
E-mail: [regulations@corp.ca.gov](mailto:regulations@corp.ca.gov)

The Department of Corporations is California's Investment and Financing Authority, reporting to the Business, Transportation and Housing Agency and the Governor. The Department is responsible for the regulation, enforcement and licensing of securities, franchises, off-exchange commodities, investment and financial services, independent escrows, consumer and commercial finance lending and residential mortgage lending. For further information or to obtain a complaint form, see the Department's Web site at [www.corp.ca.gov](http://www.corp.ca.gov) or call 1-866-ASK-CORP (1-866-275-2677).

**DEPARTMENT OF CORPORATIONS**  
*California's Investment and Financing Authority*

**WILLIAM P. WOOD**  
**California Corporations Commissioner**  
**Sacramento, California**

REQUEST FOR INFORMATION  
REGARDING THE  
CALIFORNIA CORPORATE DISCLOSURE ACT OF 2002

The Department of Corporations requests comments and information regarding the California Corporate Disclosure Act of 2002, as amended (the "Act"). See Corporations Code Sections 1502 and 2117 as amended by Assembly Bill 55 (Chapter 1015, Statutes of 2002) and Corporations Code Sections 1502.1 and 2117.1 as added by Assembly Bill 1000 (Chapter 819, Statutes of 2004). As the state securities regulator for California, the Department of Corporations has undertaken a cost-benefit study of the efficacy of the Act in providing corporate disclosure to investors at the request of the Office of the Governor.

**PURPOSE***Background*

In response to numerous corporate financial scandals and in the wake of the federal Sarbanes-Oxley Act of 2002,<sup>1</sup> California originally enacted the Act on September 27, 2002. The Act requires certain publicly traded corporations to make certain annual disclosures to the California Secretary of State within 150 days of the end of such corporation's fiscal year.

Specific disclosures required under the Act by publicly traded corporations include:

- (1) The name of the independent auditor that prepared the most recent auditor's report on the corporation's annual financial statements;
- (2) A description of other services, if any, performed for the corporation during its two most recent fiscal years and the period between the end of its most recent fiscal year and the date of the statement by the foregoing independent auditor, by its parent corporation, or by a subsidiary or corporate affiliate of the independent auditor or its parent corporation;
- (3) The name of the independent auditor employed by the corporation on the date of the statement, if different from the independent auditor listed pursuant to paragraph (1);

<sup>1</sup> Pub. L. No. 107-204, 116 Stat. 745 (2002). Among other reforms, the Sarbanes-Oxley Act created the Public Company Accounting Oversight Board, established certain standards for auditor independence, imposed additional disclosure requirements and corporate governance reforms, and enhanced penalties for securities law violations.

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- (4) The compensation for the most recent fiscal year of the corporation paid to each member of the board of directors and paid to each of the five most highly compensated executive officers of the corporation who are not members of the board of directors, including the number of any shares issued, options for shares granted, and similar equity-based compensation granted to each of those persons. If the chief executive officer is not among the five most highly compensated executive officers of the corporation, the compensation paid to the chief executive officer shall also be included;
- (5) A description of any loan, including the amount and terms of the loan, made to any member of the board of directors by the corporation during the corporation's two most recent fiscal years at an interest rate lower than the interest rate available from unaffiliated commercial lenders generally to a similarly-situated borrower;
- (6) A statement indicating whether an order for relief has been entered in a bankruptcy case with respect to the corporation, its executive officers, or members of the board of directors of the corporation during the 10 years preceding the date of the statement;
- (7) A statement indicating whether any member of the board of directors or executive officer of the corporation was convicted of fraud during the 10 years preceding the date of the statement, if the conviction has not been overturned or expunged;
- (8) A description of any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the corporation or any of its subsidiaries is a party or of which any of their property is the subject, as specified by Item 103 of Regulation S-K of the Securities and Exchange Commission (Section 229.103 of Title 12 of the Code of Federal Regulations); and
- (9) A description of any material legal proceeding during which the corporation was found legally liable by entry of a final judgment or final order that was not overturned on appeal during the five years preceding the date of the statement.<sup>2</sup>

The Act requires that each corporation submitting such information certify that such information is true and correct.<sup>3</sup> The Act applies to any publicly traded corporation that is either a California corporation or is a foreign corporation that has qualified to transact intrastate business in California, regardless of whether such corporation has any actual shareholders or beneficial owners who reside in California.<sup>4</sup>

As originally introduced, the Act was passed by the Legislature after being considered during the closing days of the 2002 legislative session. As a result of the brief consideration period, the Act was not fully reviewed by all interested parties prior to becoming law. Subsequently, certain provisions of the Act were criticized as confusing or imposing unnecessary costs on publicly

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<sup>2</sup> Cal. Corp. Code §§ 1502.1(a) and 2117.1(a).

<sup>3</sup> Cal. Corp. Code §§ 1502.1(d) and 2117.1(d).

<sup>4</sup> Section 1502.1(b)(1) of the Corporations Code defines a "publicly traded corporation" for domestic corporations as "a corporation, as defined in Section 162, that is an issuer as defined in Section 3 of the Securities Exchange Act of 1934, as amended (15 U.S.C. Sec. 78c), and has at least one class of securities listed or admitted for trading on a national securities exchange, on the National or Small-Cap Markets of the NASDAQ Stock Market, on the OTC-Bulletin Board, or on the electronic service operated by Pink Sheets, LLC." Section 2117.1(b)(1) of the Corporations Code provides a comparable definition for foreign corporations qualified to do business in California.

traded corporations, especially where the disclosure requirements of the Act differed from the disclosure requirements under the federal securities laws.

After a two-year effort to revise and clarify its provisions, the Act was amended by A.B. 1000 (Chapter 819, Statutes of 2004), which harmonized some, but not all, of the Act's disclosure requirements with the federal securities laws.<sup>5</sup> In approving A.B. 1000 on September 27, 2004, Governor Schwarzenegger stated:

“The California Corporate Disclosure Act requires publicly traded companies to disclose detailed information to the Secretary of State, most of which is already publicly available through the Securities and Exchange Commission. California is the only state in the nation to impose these burdensome and duplicative reporting requirements on business.

Although this bill does begin to fix the problems with the California Corporate Disclosure Act, I am directing the Department of Corporations to review the efficacy of the California Corporate Disclosure Act and, if appropriate, to consider sponsoring legislation to eliminate the duplicative requirements and further align its provisions with federal reporting requirements.”<sup>6</sup>

In the 2003-2004 legislative session, attempts were made to further increase the amount of disclosure provided to the Secretary of State by publicly traded corporations. Assembly Bill 2752 sought to require publicly traded corporations to file their corporate elections procedures with the Secretary of State. A.B. 2752 was passed by the legislature, but vetoed by Governor Schwarzenegger on September 22, 2004.<sup>7</sup>

### *Federal Regulation and Disclosure Requirements*

The Securities Exchange Act of 1934, as amended (the “Exchange Act”),<sup>8</sup> imposes a continuous disclosure requirement on companies registered under the Exchange Act.<sup>9</sup> Public reporting companies are required to electronically file financial statements and other information with the Securities and Exchange Commission (“SEC”) through its Electronic Data Gathering, Analysis and Retrieval system (“EDGAR”).<sup>10</sup> Filings made on EDGAR are available at all times and without cost to the public through the SEC’s website at [www.sec.gov](http://www.sec.gov).

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<sup>5</sup> For instance, the Act requires disclosure of fraud convictions and bankruptcy proceedings for the prior 10 years whereas the federal securities laws require disclosure for only the prior five years. Compare Cal. Corp. Code §§ 1502.1(a)(6)-(7) and 2117.1(a)(6)-(7) with Item 401(f) of Regulation S-K (17 C.F.R. § 229.401(f)).

<sup>6</sup> Available at [http://www.governor.ca.gov/govsite/pdf/press\\_release/AB\\_1000\\_sign.pdf](http://www.governor.ca.gov/govsite/pdf/press_release/AB_1000_sign.pdf).

<sup>7</sup> Veto message available at [http://www.governor.ca.gov/govsite/pdf/veto/AB\\_2752\\_veto.pdf](http://www.governor.ca.gov/govsite/pdf/veto/AB_2752_veto.pdf).

<sup>8</sup> 15 U.S.C. §§ 78a et seq.

<sup>9</sup> Section 13(a) of the Exchange Act (15 U.S.C. § 78m(a)). A company must register under the Exchange Act if its securities are (i) traded on a national securities exchange or (ii) its equity securities are held by more than 500 holders of record and the company has total assets in excess of \$10 million, pursuant to Sections 12(a) and 12(g) of the Exchange Act (15 U.S.C. §§ 78l(a) and 78l) and Rule 12g-1 of the Exchange Act (17 C.F.R. 240.12g-1).

<sup>10</sup> See Rule 101(a) of Regulation S-T (17 C.F.R. § 232.101(a)). The SEC began to mandate electronic filings through EDGAR in early 1993. Filers must prepare electronic filings in accordance with the procedures and technical formatting requirements set forth in the EDGAR Filer Manual promulgated by the SEC. See generally *Electronic Filing and the EDGAR System: A Regulatory Overview* (November 14, 2000) available at <http://www.sec.gov/info/edgar/overview1100.htm>.

Principal reports required to be filed electronically via EDGAR with the SEC by public reporting companies include:

- An annual report on Form 10-K or Form 10-KSB;<sup>11</sup>
- Quarterly reports on Form 10-Q or Form 10-QSB;<sup>12</sup> and
- Current reports on Form 8-K.<sup>13</sup>

Other filings made by, or relating to, public reporting companies are also filed electronically and available on EDGAR. These include proxy and tender offer solicitation materials,<sup>14</sup> reports of shareholder ownership,<sup>15</sup> and reports of transactions involving directors, officers and significant shareholders.<sup>16</sup> Public reporting companies must file numerous other documents electronically on EDGAR as exhibits to their SEC-mandated reports – such as articles of incorporation, bylaws, material contracts, and codes of ethics – which are also accessible to the public on the SEC’s website.<sup>17</sup>

Since its inception, the primary goals of EDGAR have been to facilitate the rapid dissemination of financial and business information about companies and other parties participating in U.S. capital markets, while making the delivery and the SEC’s processing of filings more efficient. The SEC has concluded that mandated electronic filing benefits both members of the investing public and the financial community by making available to them information contained in SEC filings within minutes after filing.<sup>18</sup> Over the years, the SEC has continually made system upgrades and revisions to EDGAR.<sup>19</sup>

In October 1996, President Clinton signed the National Securities Markets Improvement Act (“NSMIA”),<sup>20</sup> noting that, as a result of the legislation apportioning responsibilities between the federal government and the states, “the SEC will be charged with responsibility for activities in the national markets, such as regulation of securities listed on the national exchanges.”<sup>21</sup> NSMIA recognized that the development and growth of the U.S. capital markets had created a national market for certain securities offerings,<sup>22</sup> which should be subject to solely federal regulation (other than with respect to the application of state antifraud authority).<sup>23</sup> In enacting NSMIA, Congress recognized that the then-existing dual system of federal and state securities

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<sup>11</sup> Rule 13a-1 of the Exchange Act (17 C.F.R. § 240.13a-1).

<sup>12</sup> Rule 13a-13 of the Exchange Act (17 C.F.R. § 240.13a-13).

<sup>13</sup> Rule 13a-11 of the Exchange Act (17 C.F.R. § 240.13a-11).

<sup>14</sup> Rule 14a-6 of the Exchange Act (17 C.F.R. § 240.14a-6) and Rule 14d-3 of the Exchange Act (17 C.F.R. § 240.14d-3).

<sup>15</sup> Rule 13d-1 of the Exchange Act (17 C.F.R. § 240.13d-1).

<sup>16</sup> Rule 16a-3 of the Exchange Act (17 C.F.R. § 240.16a-3).

<sup>17</sup> See Item 601 of Regulation S-K (17 C.F.R. § 229.601).

<sup>18</sup> See *Mandated Edgar Filing for Foreign Issuers*, Securities Act Release No. 33-8016, 66 Fed. Reg. 50743 (Oct. 4, 2001).

<sup>19</sup> See *Adoption of Updated EDGAR Filer Manual*, Securities Act Release No. 33-8454, 69 Fed. Reg. 49803, 49804 n. 4 (Aug. 12, 2004).

<sup>20</sup> Pub. L. No. 104-290, 110 Stat. 3416 (1996).

<sup>21</sup> Statement on Signing the National Securities Markets Improvement Act of 1996, 32 Weekly Comp. Pres. Doc. 2038 (Oct. 14, 1996).

<sup>22</sup> See NSMIA § 102(a) (defining certain securities as “covered securities,” including securities issued by companies listed on the New York Stock Exchange, the American Stock Exchange, and the Nasdaq National Market System).

<sup>23</sup> See H.R. Conf. Rep. No. 104-864, at 39-40 (1996).

regulation had resulted in a certain amount of duplicative and unnecessary regulation, which tended “to raise the cost of capital to American issuers of securities without providing commensurate protection to investors or to our markets.”<sup>24</sup>

### *Purpose*

Accordingly, the purpose of this request is to solicit information to assist the Department of Corporations in reviewing:

- The effectiveness of the Act in protecting California investors against securities and investment fraud and providing enhanced transparency and corporate disclosure in the financial marketplace;
- The costs and other burdens imposed on publicly traded corporations (and, indirectly, the shareholders of such corporations) by the Act; and
- The cost-effectiveness of alternative methods of disclosing the information required by the Act, including through filings required and disseminated by federal regulators.

### **FOCUS OF COMMENTS**

The Department of Corporations requests interested parties to focus their comments on any or all of the following questions, in addition to providing any other relevant information:

1. Is the Act necessary? If so, why?
2. Does the Act duplicate or conflict with other laws or programs? If so, should the Act’s duplicative requirements be eliminated?
3. Whether the Act should further conform with federal reporting requirements? If so, how?
4. Have other states enacted, or are contemplating the enactment of, corporate disclosure requirements similar to the Act’s requirements?
5. What are the program and fiscal impacts to the Secretary of State and the State of California in administering the Act?
6. What are the benefits to investors and other third parties filing disclosure documents with the Secretary of State under the Act?
7. What are the burdens (including costs of compliance) of the Act on publicly traded corporations filing under its provisions?
8. How does the Act impact:
  - a. California’s business climate in general?

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<sup>24</sup> Id. at 39.

- b. The ability of California businesses to compete with businesses in other states?
  - c. The creation or elimination of jobs in California?
  - d. Businesses currently operating in California?
- 9. What alternative (including modifications or revisions to EDGAR) are available that would:
  - a. Be more effective in carrying out the purpose of the Act?
  - b. Be as effective but less burdensome to any affected business than the Act?
  - c. Lessen any adverse impact on small business?

## WRITTEN COMMENTS

Any interested party may submit written comments to the Department of Corporations. Please reference PRO 03/05 in written comments to the Department and submit them by **January 14, 2005** (or as early as possible) to:

Kathy Womack  
Office of Law and Legislation  
Department of Corporations  
1515 K Street, Suite 200  
Sacramento, CA 95814

Written comments may also be sent to Kathy Womack (1) via electronic mail at [regulations@corp.ca.gov](mailto:regulations@corp.ca.gov) or (2) via fax at (916) 322-3205.

The Department may, but is not required to, hold one or more informational hearings regarding the subject matter of this request for information.

## CONTACT PERSON

Inquiries regarding this Request for Information may be directed to Timothy L. Le Bas at (916) 322-3553.

Dated: December 1, 2004

WILLIAM P. WOOD  
California Corporations Commissioner

By \_\_\_\_\_  
TIMOTHY L. Le BAS  
Deputy Commissioner and General Counsel  
Office of Law and Legislation  
(916) 322-3553